The Changing Face of Central Banking: the Great Reversal

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Motivation

• After the Financial Crisis politicians in several countries reconsidered – and still they are reconsidering - the features of their supervisory architecture and the role of the central banks

• Three (intertwined) key questions: How to design the supervisory architecture? How to involve the central bank? How to define the authority governance?

• Conclusion: We are observing a sort of “Great Reversal” which challenges the Mainstream

• Approach: Theory, Institutions and Empirics
Background Articles

Before the Crisis

- **Three Trends:**
  - Supervision: **Consolidation**
  - Central Bank Role: **Specialization** as Monetary Policy Agent
  - Governance: **Independence** and **Accountability**
1) Supervision

• Traditional Model: Multi-Authorities (Silos) Model:

B → BMrkts
S → SMrkts
I → IMrkts
1) Supervision

• But integrated markets call for supervisory reforms:
A wave of reforms …
... In the OECD countries
Supervision

• Consensus: Light Touch Regulation
• Effects:
  • 1) Splitting between Regulation and Supervision
  • 2) Innovative (more Consolidated) Models:
    • A) Single Supervisor (Unified) Model
    • B) Peaks Model
The Unified Model

UNIFIED SUPERVISOR

US

GLOBAL FINANCIAL MARKETS
The Peaks Model

STABILITY SUPERVISOR

CONDUCT OF BUSINESS (SUPERVISOR)

GLOBAL FINANCIAL MARKETS
Europe: from Fragmentation …
... to Consolidation
2) Central Bank

- Central Bank: Less Supervision
Specialization

- The “traditional” countries show a common feature: the central bank is the sole (or the main) banking supervisor in the 80 per cent of the sample (61 on 76).
- At the same time, the adoption of an innovative model of supervision is centred on the role of the central bank in only very few cases (5 on 26 cases, 20 per cent).
Specialization

• Traditional Model: Central Bank as Banking and Monetary Agent

• But:

• Monetary Policy Effectiveness needs a Specialized Central Bank

• Then: CB as Monetary Agent
Reshaping the CB regime

Society

Politicians

Central Bank

Committed Mandate

Optimal Monetary Policy
Specialization

• Effects: 1) **Less Central Bank Involvement** in Supervision
  
• 2) **Governance Matters** (Independence and Accountability), before for Central Banking and then for Supervision
Central Bank and Supervision

Source: Romelli 2012
3) Governance

• **Good Governance** = Ratings for Independence and Accountability
CBI: Global Trends

Figure 7. Global Trends in CBA

1980s: Cukierman sample narrow index.
2003: all countries full index.
Source: Cukierman (1992) and authors’ estimates.
CBI Trends: Advanced economies

Figure 8. Trends in CBA for Advanced Economies

1980s: GMT sample full index.
2003: all countries full index
Source: GMT (1991) and authors’ estimates.
CBI Trends: Emerging markets

Figure 9. Trends in CBA Autonomy for Emerging Markets

1980s: Cukierman sample narrow index.
2003: all countries full index.
Source: Cukierman (1992) and authors’ estimates.
CBI Trends: Developing countries

Figure 10. Trends in CBA for Selected Developing Countries

1980s: Cukierman sample narrow index.
2003: all countries full index.
Source: Cukierman (1992) and authors’ estimates.
Before the Crisis: Follow up

• A) **Supervisory consolidation** outside the central bank

• B) **Agency Specialisation**

• C) **Good Governance**: Independence, Accountability

Therefore: **Convergence**

• **NOTE**: No distinction between macro and micro supervision
Crisis and Supervisory Indexes: Empirical Evidence

• Results:
  – Negative relationship between public sector governance and resilience dominates
  – Negative relationships between consolidation and governance index and resilience (most of the times significant)
  – Central bank involvement had no significant impact
After the Crisis: Consolidation in trouble
After the Crisis: Consolidation in trouble
After the Crisis: Consolidation in trouble

- **HYBRID MODEL**
  - “Traditional” Federal Financial Supervisors
  - Financial Oversight Council

- **SILOS MODEL**
  - Consumer Protection Agency
  - Banking Markets
  - Securities Markets
  - Insurance Markets

- **FEDERAL MODEL**
  - State Financial Supervisors
  - FED
After the Crisis: Consolidation in trouble

PEAKS MODEL

ECB → European System of Financial Supervisors → European Systemic Risk Board → European Banking Authority

SILOS MODEL

ECB → National Financial Supervisors

FEDERAL MODEL

ECB → European Securities and Markets Authority → European Insurance and Occupational Pensions Authority
After the Crisis: Less Specialization

FIGURE 2 CENTRAL BANK INVOLVEMENT IN SUPERVISION

<table>
<thead>
<tr>
<th>COUNTRIES</th>
<th>CBSS INDEX</th>
</tr>
</thead>
<tbody>
<tr>
<td>ALL</td>
<td>30</td>
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<tr>
<td>OECD</td>
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<td>EUROPE</td>
<td>22</td>
</tr>
<tr>
<td>EU</td>
<td>25</td>
</tr>
</tbody>
</table>
After the Crisis: Less Specialization
After the Crisis: Governance in Trouble?

- Society
- Politicians
- Banking Industry
- How Many Goals?
- CB Regime
- How many Instruments?

CAPTURE RISK!
INDEPENDENCE?
Conclusion

• Before the Crisis: “Natural” Convergence
• After the Crisis: The Great Reversal
• Approach: More Political Economy, More Law & Economics, rather than Economics *per se*